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TOM REILLY
ATTORNEY GENERAL

July 21, 2003

Mary L Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2d Fl.
Boston, MA

Re: KeySpan, D.T.E. 03-40

Dear Secretary Cottrell:

Enclosed for filing please find responses of Lee Smith to Bay State Gas Company on behalf of the Attorney General. Thank you.

Sincerely,

Edward G. Bohlen
Assistant Attorney General

Enclosures

Q: Please refer to the Prefiled Direct Testimony of Lee Smith ("Smith Testimony") at page 3, lines 6-10. Please list each and every PBR plan that Ms. Smith has studied to support the statements made here, including in her answer (a) the name of utility; (b) jurisdiction; (c) year the PBR was approved by the state commission; and (d) docket number.

A: I reviewed the following: (i) decision D.99-05-030 issued May 13, 1999 by the California Public Utilities Commission, which adopted a PBR base rate mechanism for San Diego Gas & Electric Company's electric and gas divisions; (ii) a February 1998 decision issued by the Maine Public Utilities Commission in docket No. 97-116 adopting a PBR mechanism for Bangor Hydro effective January 1, 1999 though February 29, 2000; (iii) the MPUC Order in 97-795, 1998, in a Bangor Gas Company case; (iv) a September 2000 decision issued by the Maine Commission in docket No. 99-666, which approved a new alternative rate plan for Central Maine Power; (v) the decision issued by the Massachusetts DTE in docket DPU 96-50-A (Phase 1) relating to Boston Gas' PBR plan; and (vi) the decision issued by the Massachusetts DTE in docket DTE 01-56 relating to Berkshire Gas' PBR plan.

In addition, I reviewed summaries (prepared by CPUC Staff) of the following CPUC decisions: (i) D.96-09-092 issued 1996 relating Southern California Edison's T&D PBR mechanism; and (ii) D.97-07-054 issued July 16, 1997 relating to Southern California Gas Company base rate mechanism as well as implementation filings.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-2
Date: July 21, 2003

Q: Please refer to the Smith Testimony, page 5, line 27. Please state what is meant by "another PEG study" and provide a copy of it.

A: The study is that of TXU, Australia, which has been provided in response to AG-12-14.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-3
Date: July 21, 2003

Q: Please refer to the Smith Testimony, page 5, lines 28-30. Please explain in detail why Ms. Smith believes that if gas company costs are higher, the rate of change in productivity may not be affected. Please provide all supporting documentation.

A: The study estimates productivity change, which is determined by examining the rate of change of outputs compared to the rate of change of the cost inputs; gas company costs could be either higher or lower and the productivity growth would be the same if the rate of growth of costs was the same. No documentation is necessary.

Q: Please refer to the Smith Testimony, pages 5-6, at lines 30-31 and 1-6, respectively. Please explain in detail Ms. Smith's basis for the statements that appear in that paragraph and provide all supporting documentation relied upon by Ms. Smith for each of the statements made.

A: See the response to BSG 1-3.

Q: Please refer to the Smith Testimony, page 6 at lines 18-22. Please reconcile the criticism of Dr. Kaufman's use of utilities in the Northeast with Ms. Smith's findings that utilities in the Northeast may have different costs than others nationwide, as presented at Smith Testimony, page 18, lines 23-24.

A: See the response to BSG 1-3.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-6
Date: July 21, 2003

Q: Please refer to the Smith Testimony, page 8, lines 1-3. If a "medium to long-term" review of productivity growth is necessary, please define what period in years Ms. Smith would consider reasonable. Provide all documentation that Ms. Smith relies upon in drawing this conclusion.

A: I have not performed an analysis to determine the most appropriate period for comparison, although the changes in the relative price of gas and oil during this period suggest that 1990-2000 were not comparable periods for the gas industry. The point of my testimony is that Dr. Kaufman has also not performed such an analysis. The period of analysis should be such that results are not skewed by short-term changes in use due to relative fuel prices, weather, and other factors.

Q: Please provide all documentation relied upon by Ms. Smith to support her statement that "most projections are that economic growth will be slower in the next five years" as stated on page 9, lines 3-5 of the Smith Testimony.

A: The information on which this statement is based is extensive. Attached is a projection by the Congressional Office of the Budget, which forecasts growth of 3% per year. Recently Federal Reserve Chairman Alan Greenspan has expressed concern that if gas prices remain high this will depress economic growth, presumably below that forecasted.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-8
Date: July 21, 2003

Q: Please provide all documentation relied upon by Ms. Smith to support her statement that "[a]ll else being equal, the magnitude of this relative change [in gas prices as compared to oil] can be expected to lead to a reduction in gas use" as stated on page 10, lines 3-5 of the Smith Testimony.

A:` Since gas and oil are substitutes for many uses, if oil prices fall relative to gas prices, many customers will switch from using gas to using oil. Dr. Kaufman testified orally (transcript Vol. 11, p. 1355) that Boston Gas future productivity could go down if oil prices decreased relative to gas, because gas sales would decrease.

Q: Please refer to page 11, lines 28-30 and page 12, lines 1-2. (a) Please list the "many utilities in several states." (b) Provide a detailed explanation and all documentation relied upon by Ms. Smith in her assertion that the components of delivery service are not "dramatically different" between gas and electric utilities. (c) Please provide in list form each and every difference, if any, between the components of delivery service for natural gas and that for electricity.

A: (a) In Pennsylvania, all of the electric utilities operated under distribution rate caps from 1998 to the present. In Massachusetts, all of the electric utilities have been operating under distribution rate caps since the Restructuring legislation. In Arizona, Arizona Public Service has been reducing its total rates since 2001 and its distribution rates since about 1996.

(b) Gas and electric are both capital intensive industries; operating and maintenance expenses for both consist of maintaining lines or pipe spread over the entire territory, and providing customer service. Both industries' revenues are sensitive to weather and to changes in the price of energy substitutes.

(c)

- In most areas, electric utilities must extend service to new customers, but gas utilities are not required to;

- Electric maintenance involves both under and above ground work, while most gas work involves underground work.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-10
Date: July 21, 2003

Q: Please refer to page 12, lines 9-11 of the Smith Testimony. Please provide a list of every state commission, of which Ms. Smith is aware, that assumes that absent a PBR the productivity factors for a regulated gas utility are similar to the private sector, providing, at the minimum, (a) the name of utility; (b) jurisdiction; (c) year the PBR was approved by the state commission; and (d) docket number of relevant order.

A: The various Commissions have taken different approaches to the various components of PBR, so that it is difficult to identify a specific position taken on productivity growth absent PBR. There is evidence in the Bangor Gas case listed in my response to BSG 1-1 that the Maine Commission believed that gas productivity would rise at a higher rate than the private sector.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-11
Date: July 21, 2003

Q: Please refer to page 12, lines 13-19 of the Smith Testimony. (a) Is this list comprehensive? If not, what additional factors, if any, would contribute to productivity improvements? (b) In Ms. Smith's view, do these differ from productivity improvements that may be available to the private sector? (c) What factors, in Ms. Smith's estimation, exist that may contribute to increased costs for a regulated gas utility? (d) Is Ms. Smith aware of any trends at all that affect natural gas utilities that may cause increased costs at a rate faster than the general rate of inflation?

A: a.) The list is not comprehensive, although these are the major factors. Another factor would be a better trained workforce.

b.) No.

c.) The question is unclear.

d.) No.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-12
Date: July 21, 2003

Q: Please refer to the Smith Testimony at page 16. Please justify, providing with the explanation all supporting documentation, why Boston Gas' consumer dividend would not be less in the 2nd five years? As part of her response, Ms. Smith should clearly state and justify her position as to whether the consumer dividend is sustainable each year over the long term.

A: The consumer dividend should not be less in the second five years because: 1) it is likely that the utility will still be changing its *modus operandi*, leading to increasing productivity; 2) Boston Gas is more likely to still be consolidating operations in the second 5 years than to have made all changes and instituted all efficiencies that were possible as a result of the mergers; and 3) the California commission, which has undertaken extensive study of PBR, has approved PBR plans that included increasing consumer dividends, and the gas utilities operating under these have not suffered financial reversals as a result. This evidence indicates that the consumer dividend should be sustainable over the next five years.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-13
Date: July 21, 2003

Q: In Ms. Smith's opinion, are there efficiencies that Boston Gas would only pursue under a PBR setting? Please provide all information that supports Ms. Smith's response.

A: There may be some efficiencies that are more likely to be pursued under a PBR setting than under cost of service.

Q: In Ms. Smith's opinion, is cost of service regulation a model that promotes efficiency? Please provide all information that supports Ms. Smith's response.

A: Cost of service regulation may promote efficiency gains that require little capital and are quickly implemented, particularly when the utility's costs are rising; increasing productivity can avoid the necessity of continually filing rate cases. Cost of service regulation will promote efficiency gains when costs are increasing slowly and where the utility has a good chance of not being called in for a rate reduction when it reduces its average costs.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-15
Date: July 21, 2003

Q: Please see the Smith Testimony at page 18, lines 18-25. (a) Please discuss in greater detail Ms. Smith's belief that construction costs are less expensive in the Northeast, providing specific examples and all supporting documentation. (b) Is Ms. Smith aware of any factors that make the construction for gas utilities associated with one more customer more expensive in the Northeast? Please fully explain the response.

A: a) Ms. Smith's testimony did not indicate that construction costs are less expensive in the Northeast.

b) Ms. Smith expects that the cost of adding distribution lines to serve a new customer is greater in regions with deeper frost-depth, with earthquake danger, and is greater where most of the construction requires digging up streets. It is unclear how the Northeast as a whole compares to PEG's national sample.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-16
Date: July 21, 2003

Q: Please refer to the Smith Testimony at page 18, lines 24-27. Please support, with documentation if available, Ms. Smith's statement that there will be a large difference in the cost of adding a new service on an existing distribution line, and the cost (justified by incremental revenues and customer contributions as required by the Department) of adding a customer that requires construction of a new distribution line.

A: Adding a new customer requiring construction of distribution line clearly adds more costs than adding a new customer on an existing line. No documentation is necessary to establish this basic fact. If the addition has been justified by its incremental revenues, this simply means that revenues will be adequate to justify the investment, not that costs will not increase.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-17
Date: July 21, 2003

Q: Please refer to the Smith Testimony at page 19, lines 1-6. Ms. Smith states: "I expect that Boston Gas' system is dense relative to the nationwide sample." Please support this statement, using the referenced nationwide sample as the basis.

A: The statement was "I expect." This is based on general knowledge gas systems in the Midwest and West tend to serve territories that are much more rural in nature than in the East. For instance, most of Illinois and Ohio, including quite rural areas, are served by gas lines, whereas to my knowledge New England gas utilities have generally not served such areas.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-18
Date: July 21, 2003

Q: Please refer to Smith Testimony at page 19, line 17. Provide Ms. Smith's measure of density. Justify.

A: Density could be measured in a number of ways, but number of customers per mile of main would be one such measure.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-19
Date: July 21, 2003

Q: Please briefly describe the filed positions of full parties to this proceeding that would support Ms. Smith's claim that only 50% of the Attorney General's proposed revenue requirement will be adopted by the Department, as referred to on page 23, lines 6-17.

A: Ms. Smith did not "claim" that only 50% of the proposed revenue requirement would be adopted.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-20
Date: July 21, 2003

Q: Please refer to the Smith Testimony at page 21, lines 26-29, page 22, lines 10-14, and page 23, lines 6-8. Is there any evidence that Boston Gas did not effect the maximum efficiency opportunities first, in order to then move on to the lesser efficiencies? If so, please provide copies of all such evidence and documentation.

A: There is no evidence that Boston Gas did effect the maximum efficiency opportunities first. More importantly, increasing productivity should result in changing the corporate mindset, so that new efficiencies are discovered over time. To quote KEDNE/LRK-6, achievement of performance gains is first and foremost a discovery process in which more efficient operating practices and superior use of technology are learned over time. (p. 59)

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-21
Date: July 21, 2003

Q: Please refer to the Smith Testimony at page 23, lines 12-15. (a) List each of the "electric distribution companies that reduced their labor forces" as a result of competitive pressures and rate caps. (b) List each electric distribution company that reduced its labor force as a result of generation divestiture (and by force of law, such as St. 1997, ch. 164) or functional divestiture of transmission assets, the operational management of which has been turned over to the ISO in many regions.

A: These lists are not comprehensive.

(a) Boston Edison has been reducing its labor force since several years before divestiture. Likewise Central Maine Power and Public Service of New Hampshire have been reducing their labor force both before and after divestiture.

(b) Presumably all utilities that have divested all of their generating assets have reduced their labor force.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-22
Date: July 21, 2003

Q: Please refer to the Smith Testimony at page 23, lines22 through 26. Justify by whatever means possible Ms. Smith's statement that a regulated utility would delay (until a test year) implementation of technological changes proven to benefit ratepayers through better and possibly increased distribution service and lower costs.

A: Ms. Smith did not state that a utility would delay implementation of a technological change, but did state that under cost of service regulation there was an incentive for the utility to delay implementation.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-23
Date: July 21, 2003

Q: Please see the Smith Testimony at page 24, lines 9-10. Please identify what evidence would constitute "clear" evidence that a merger has resulted in a more efficient utility.

A: What constitutes "clear" evidence depends on circumstances. Evidence showing: 1) quantifiable net present benefits to consumers as a result of the merger; 2) that the utility's full cost of service after the merger was less than would have been expected, given the normal past pattern of cost behavior; or 3) that specific costs had decreased without corresponding cost increases elsewhere would be evidence of efficiency from a merger.

Q: Please see the Smith Testimony at page 24, lines 14-20.

(a) Please list all PBR plans that Ms. Smith is "familiar with" for (1) gas distribution utilities and (2) electric distribution utilities.

(b) (1) Please provide the names of the gas utilities and the fundamental of the PBRs approved by the California Public Utilities Commission. (2) For each, please list the (i) name of the utility, (ii) the key provisions of the approved PBR, (iii) the docket number and (iv) the year approved.

A: See the response to BSG-1-1.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-25
Date: July 21, 2003

Q: In Ms. Smith's opinion, is it possible for cost of service regulation to exist along side of PBR for different utilities in the same regulatory forum? If so, what criteria would Ms. Smith propose be adopted by the Department to determine which utilities be subject to a PBR and which should be subject to cost of service regulation? Please be specific.

A: Yes, it is possible. I have not considered what criteria would be appropriate.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-26
Date: July 21, 2003

Q: Please see the Smith Testimony at page 24, lines 25-30, and page 25, lines 1-7. (a) Is traditional cost of service regulation the only alternative to a PBR? If not, please describe in detail other alternatives considered by Ms. Smith. (b) Would fully litigated cast-off rates plus a measure of inflation, present a workable alternative in Ms. Smith's estimation? Please fully explain the answer. (c) Please fully explain both the benefit(s) and the detriment(s) to consumers of a return to cost of service regulation, in Ms. Smith's opinion.

A: I have not testified as to other ratemaking methodologies, nor are other methodologies the subject of this proceeding. The benefits and detriments of returning to cost of service would depend on the circumstances.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-27
Date: July 21, 2003

Q: Please see the Smith Testimony at page 25, line 10-18. Is the risk of PBR truly greater than the potential reward to customers, or is it really a break-even? Please explain the answer.

A: The risks of PBR are greater. The types of risk are explained on p. 25, lines 10-25. The only clear benefit is the reduction of rate case expense compared to the PBR case, and the amount of rate cast expense depends on how often the utility files rate cases and what period the DTE uses to normalize rate case expenses.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-BSG-1-28
Date: July 21, 2003

Q: Please see the Smith Testimony at page 25, lines 20-25. (a) How is this scenario different when a company is fully subject to cost of service regulation? Please explain in detail. (b) Does the power of the Department to ensure rates are just and reasonable impact Ms. Smith's analysis? Please explain.

A: If rates are originally set "too high", so that the Company earns above its authorized ROE, without PBR there will be no further rate increase until the Company's ROE falls enough below a fair ROE to justify another rate increase. With PBR, the Company will receive a rate increase automatically, unless its ROE rises above the bandwidth specified in the proposed Earnings Sharing Mechanism.